STATE OF MICHIGAN

COURT OF APPEALS

V & J FOODS OF MICHIGAN,

Petitioner-Appellant,

v

DEPARTMENT OF TREASURY,

Respondent-Appellee.

UNPUBLISHED
May 23, 2006

No. 259460
Tax Tribunal
LC No. 00-295871

Before: Borrello, P.J., and Saad and Wilder, JJ.

PER CURIAM.

Petitioner appeals as of right from the Michigan Tax Tribunal's November 10, 2004 opinion and judgment affirming respondent's single business tax assessments against petitioner. For the reasons set forth in this opinion, we affirm.

Petitioner is a franchisee of Burger King Restaurants in Michigan. Under the terms of its franchise agreements with Burger King Corporation (BKC), petitioner pays the following fees: a franchise fee in the amount of $10, a monthly advertising fee of 4% of its gross sales, and a monthly royalty fee of 3.5% of its gross sales. Petitioner reported the expense incurred under the royalty fee on its federal income tax returns, but did not add it back into the computation of its single business tax base for purposes of Michigan's Single Business Tax Act (SBTA), MCL 208.1, *et seq*. Petitioner was audited by respondent and assessed $104,107 plus interest, for the failure to add the royalty expense back into the computation of its single business tax base as required by MCL 208.9(4)(g). Petitioner appealed to the Michigan Tax Tribunal, arguing that a large percentage of the payments designated as "royalty" payments under the parties' franchise agreement are, in fact, payments for services and, therefore, are not "royalties." Petitioner also asserted that the tribunal must consider extrinsic evidence on the intent of the parties with respect to the "royalty" payments, even if it contradicts or supplements the franchise agreement. The tribunal affirmed the assessment, relying on the language of the franchise agreement.

"This Court's review of Tax Tribunal decisions is very limited." *Columbia Assoc, LP v Dep't of Treasury*, 250 Mich App 656, 665; 649 NW2d 760 (2002). Absent a claim of fraud, we can only determine whether the tribunal committed an error of law or adopted the wrong legal principle. *Id*. In addition, we will not disturb the tribunal's factual findings if they are supported by competent, material, and substantial evidence on the whole record. *Id*. And when, as here, a case is submitted to a governmental agency on stipulated facts, those facts are taken as conclusive. *Id*.

Michigan imposes a single business tax on the privilege of doing business in this state. MCL 208.31(3). However, the single business tax is not an income tax. *Columbia, supra* at 666. Rather, it "'represents a value added tax that measures the increase in the value of goods and services brought about by whatever a business does to them between the time of purchase and the time of sale.'" *Id*., quoting *Guardian Photo, Inc v Dep't of Treasury*, 243 Mich App 270, 227; 621 NW2d 233 (2000). Thus, under the SBTA, businesses are taxed for what they have added to the Michigan economy, not what they have derived from the economy. *Id*. at 666-667.

Under MCL 208.31(1), the single business tax is levied and imposed on "the adjusted tax base of every person with business activity in this state that is allocated or apportioned to this state . . . ." Therefore, "the first step in determining a taxpayer's single business tax liability is to determine its tax base." *Little Ceasar Enterprises, Inc v Dep't of Treasury*, 226 Mich App 624, 627; 575 NW2d 562 (1997). "The tax base is the taxpayer's business income before apportionment, subject to certain upward or downward adjustments." *Id*. The adjustment at issue in this case, MCL 208.9(4)(g), requires the taxpayer to add back to their tax base "all royalties" paid that were deducted on their federal income tax, unless the royalty falls within one of the enumerated exceptions.

Other than listing the exceptions, the SBTA does not define a royalty. See MCL 208.9(4)(g). However, this Court has concluded that a royalty has three key characteristics: "'(1) it is a payment, (2) in the form of either a product itself or proceeds from the sale of the product, and (3) made in consideration of the use of the property.'" *Columbia, supra* at 673 (citation omitted). In other words, a royalty is a payment received for the use of property. *Mourad Bros, Inc v Dep't of Treasury*, 171 Mich App 792, 796; 431 NW2d 98 (1988). But it is not a payment for services or a payment for advertising. *Id*. at 800.

Petitioner argues that the tax tribunal erred in concluding that under MCL 208.9(4)(g), it must add back to its single business tax base the entire amount of the royalty payments under the franchise agreement because, according to the plain language of the agreement, the royalty payments were for the use of BKC's property, not for the services BKC rendered to petitioner. Petitioner contends that although the franchise agreement labels those payments as royalties, the reality is that a portion of those payments is for the services that BKC provides petitioner, not for the use of BKC's property. Petitioner further contends that the tax tribunal was required to consider the extrinsic evidence it proffered to support that the payments were, in fact, for both the services and the use of property.

The relevant portion of the agreement states as follows:

> 8. ROYALTY AND ADVERTISING CONTRIBUTION
>
> A. Royalty
>
> FRANCHISEE agrees to pay to BKC a royalty of 3.5% of gross sales for the use of the Burger King System and the Burger King Marks. Royalties shall be paid monthly by the Tenth (10^{th}) day of each month based on gross sales for the preceding month.

The Random House College Dictionary defines "royalty" as:

"[A] compensation or portion of the proceeds *paid* to the owner of a right, as a patent or oil or mineral right, for the use of it . . . an agreed portion of the income from a work paid to its author, composer, etc., usually a percentage of the retail price of each copy sold . . . a royal right, as over minerals, granted by a sovereign to a person or corporation . . . the payment made for such a right."

* * *

Black's Law Dictionary defines royalty as:

"Compensation for the use of property, usually copyrighted material or natural resources, expressed as a percentage of receipts from using the property or as an account per unit produced. A payment which is made to an author or composer by and assignee, licensee or copyright holder in respect of each copy of his work which is sold, or to an inventor in respect of each article sold under the patent. Royalty is share of product or profit reserved by owner for permitting another to use the property. . . . In mining and oil operations, a share of the product or profit *paid* to the owner of the property." [*Id*. at 484 (Citations omitted; emphasis, omissions, and alterations in original).]

Utilizing the definition provided by this Court in *Mobil Oil Corp v Dep't of Treasury*, 422 Mich 473, 476; 373 NW 2d 730 (1985) and *Mourad, supra*, a royalty is a payment received for the use of property. *Mourad*, 171 Mich App 796, citing *Mobil Oil*, at 485. But it is not a payment for services or a payment for advertising. *Id*. at 800.

Petitioner relies on *Mourad* to argue that the tribunal erred in not looking beyond the terms of the franchise agreement. *Mourad*, however, is distinguishable from the instant action. In *Mourad*, this Court was faced with a franchise fee that had no allocation as to what percentage constituted a royalty, even though it was clear that a portion of the franchise fee was for payment for the use of the franchisor's property. *Id.* at 794. Therefore, the franchise agreement in *Mourad* was ambiguous, requiring this Court to look outside of the parties' agreement. *Id.* at 800. Here, there is a clear allocation of the fees: the parties' franchise agreement allocates a specific amount for the franchise fee, advertising, and royalties. The franchise agreement between petitioner and BKC clearly states that the monthly royalty payment in the amount 3.5% of the petitioner's gross sales is paid to the franchisor for the use of BKC's system and its marks, i.e., its property. Therefore, the tribunal was not required to look outside the parties' agreement to determine what portion of the fees they intended to be allocated as a royalty because it was specifically stated in the contract. See *Mid-America Mgt Corp v Dept' of Treasury*, 153 Mich App 446, 459-460; 395 NW2d 702 (1986) (explaining that extrinsic evidence is not admissible to vary a contract that is clear and unambiguous).

Based on our review, we conclude that the tax tribunal did not err in requiring petitioner to add back to its single business tax base the entire amount of the royalty payments.

Affirmed.

/s/ Stephen L. Borrello
/s/ Henry William Saad
/s/ Kurtis T. Wilder